revenue loss. 40/ Lessening the amount of investment in housing--through any of these approaches--could also result in somewhat higher mortgage interest rates and in the reallocation of funds to other sectors of the economy, if the total supply of mortgage funds was also reduced.

Another approach would be to repeal the bad debt reserve tax deduction--increasing federal revenues and lessening the incentive for thrift institutions to invest in housing. If the deduction was repealed, it could then be replaced by a generally available tax credit for all interest income earned on mortgages and MBSs. Such a tax credit would benefit all mortgage investors equally--spreading the subsidy from the tax treatment of mortgage interest among a greater number of institutions and individuals than currently receive it. On the other hand, a mortgage interest tax credit would continue to favor mortgage investment over other credit uses such as business plant and equipment.

Either eliminating the bad debt reserve tax deduction or replacing it with a more efficient subsidy would further federal deregulation of the housing finance system.

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40. Another change would be to make the qualifying level of assets the same percentage for both savings and loan associations and mutual savings banks. This would eliminate the existing incentive for savings and loan associations to recharter as mutual savings banks to be able to take the maximum tax deduction on the basis of a smaller percentage of qualifying assets.

APPENDIX A. ADDITIONAL INFORMATION ON FEDERAL HOUSING FINANCE INSTITUTIONS

MORTGAGE INSURANCE AGENCIES

The Federal Housing Administration

The 1934 National Housing Act established the Federal Housing Administration (FHA) to insure residential mortgages and thereby encourage their trading in the secondary mortgage market. Because the private mortgage associations authorized by Title III of the act in order to stimulate a private secondary market did not develop, the secondary mortgage market became primarily a federally supported entity.

The FHA, now part of the U.S. Department of Housing and Urban Development (HUD), has developed 40 mortgage/loan insurance programs in four separate insurance funds--the Mutual Mortgage Insurance Fund, the Cooperative Management Housing Insurance Fund, the General Insurance Fund, and the Special Risk Insurance Fund.

The Mutual Mortgage Insurance Fund (MMIF), the largest of the FHA funds, includes the major single-family insurance program--Section 203(b) of the 1934 National Housing Act, as amended. As a mutual fund, the MMIF pays participants under the Section 203(b) program a rebate of premiums not required for expenses or losses.

The Cooperative Management Housing Insurance Fund (CMHIF), also a mutual fund, provides mortgage insurance for management-type cooperatives and supplementary loans under Section 213 of the 1934 National Housing Act, as amended. Under the Section 213 program, HUD insures mortgages made by private lending institutions on cooperative housing projects of five or more dwelling units to be occupied by members of nonprofit cooperative ownership housing corporations. The supplementary loans may finance: new construction, rehabilitation, acquisition, improvement, or repair of a project already owned, and resale of individual memberships; construction of projects composed of individual family dwellings to be bought by individual members with separately insured mortgages; and construction or rehabilitation of projects that the owners intend to sell to nonprofit cooperatives.

The General Insurance Fund (GIF) provides insurance in a wide variety of special purpose programs including insurance programs for loans on property repairs and improvements; on basic and special purpose multifamily housing; on urban renewal, middle-income, and armed forces housing; and on war and defense housing. The GIF has incurred financial losses over the years.

The Special Risk Insurance Fund (SRIF) insures mortgages in older, declining urban areas which otherwise would not be eligible for mortgage insurance (Section 223(e)), and mortgages covering experimental housing where strict adherence to state or local building regulations is not observed (Section 233). Mortgagors who are eligible for mortgage insurance after receiving housing counseling (Section 237) and those receiving interest reduction payments (Sections 235 and 236) also receive insurance through this fund. The SRIF has also incurred financial losses from its operations.

The FHA meets operating expenses in excess of premium collections by its funds in several ways. Prior to 1976, the FHA financed losses mainly by using its open-end Treasury borrowing authority. Since 1976, the FHA has been authorized to receive annual appropriations to restore losses sustained as a result of the operations of the General Insurance and the Special Risk Insurance Funds.

The Veterans Administration

Under the Veterans Administration's (VA) loan guarantee program--established by the 1944 Servicemen's Readjustment Act--assistance is provided to eligible home purchasers by substituting the government's guarantee of payment on private loans for down payments and other requirements associated with conventional mortgage transactions. As a result of the Veterans Housing Act of 1970, eligible veterans and active-duty service personnel also can receive the VA guarantee on loans for mobile homes, for refinancing, and for condominiums, as well as for single-family homes.

The 1974 Veterans Housing Act further expanded loan eligibility under the VA guarantee program. The act increased the pool of condominium projects eligible for VA-approved loans and allowed veterans who had previously obtained a loan to regain entitlement for another loan if the original property is disposed of and the loan is paid in full, or if another eligible veteran assumes the balance of the VA loan and substitutes his/her own entitlement. The 1974 act also allowed nonsupervised lenders who meet VA standards to make guaranteed loans without prior VA approval.

The Omnibus Reconciliation Act of 1982 established a fee of one-half percent of the principal value of the loan for most loans closed between October 1, 1982, and September 30, 1985, which may be added to the loan amount.

SECONDARY MARKET ENTITIES

The Government National Mortgage Association

The Government National Mortgage Association (GNMA)--an agency of the U.S. Department of Housing and Urban Development--was established in 1968 to assume the government functions of the Federal National Mortgage Association (FNMA), which was privatized at the same time. 1/

The GNMA has four primary functions, two of which were inherited from the FNMA. Under the special assistance function programs, which are similar to predecessor programs operated by the FNMA, the GNMA purchases and resells at a loss privately written reduced-interest mortgages to provide support for types of housing for which financing is not readily available, such as rental housing for low-income families. Under the management and liquidation function--also inherited from the FNMA--the GNMA manages and liquidates a portfolio of federally owned mortgages with minimum adverse effect on the home mortgage market and minimum loss to the government. GNMA also has authority under the emergency mortgage purchase assistance program to provide countercyclical housing assistance. Finally, the GNMA operates the mortgage-backed security (MBS) program, discussed in Chapters III and IV of the paper.

The GNMA MBS program is self-supporting from its fee revenue and has made several innovations in the market for MBSs. Revenues in the GNMA MBS program come from an issuer application fee, a commitment application fee, and a fee of 0.06 percent of the security's value paid by the institutional issuer for the GNMA guarantee. 2/ The GNMA MBS program has developed both the modified passthrough security--which channels principal and interest payments to investors even if borrowers fail to make monthly payments on the underlying mortgages--and an organized futures market in MBSs. The FNMA handles the daily administration of the GNMA MBS program.

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1. Both of these changes were accomplished by amending Title VIII of the 1934 National Housing Act in the 1968 Housing and Urban Development Act.

2. A fee of 0.44 percent of the security's value is paid to the issuer for servicing the mortgage pool. The Issuer Application Fee and the Commitment Application Fee are discussed in Chapters IV and V.

The Federal National Mortgage Association

The Federal National Mortgage Association (FNMA) was established in 1938 as a wholly-owned public subsidiary of the Reconstruction Finance Corporation (RFC), a federally chartered public corporation. The FNMA was chartered as a federally owned and operated national mortgage company to trade mortgages backed by the federal government because the RFC Mortgage Corporation--another subsidiary of the RFC established in 1935--had failed to establish a private secondary market in residential mortgages. Although the FNMA was intended to be a private entity and to pay for its operations with fees, it developed instead as a publicly owned agency. Eventually, the 1968 Housing and Urban Development Act established the FNMA as a private taxpaying corporation by transferring its public functions to the newly established GNMA.

The FNMA is authorized to service, lend on the security of, or otherwise deal in both government-insured or -guaranteed and conventional mortgages. 3/ The FNMA finances its mortgage holdings by issuing debt in the capital market and by issuing common stock that is traded on the New York Stock Exchange.

In recent years, the FNMA has operated in deficit because it holds a portfolio dominated by its past purchases of low-yielding, fixed-rate, 30-year mortgage loans. Traditionally, the FNMA has sold less than 10 percent and often less than 1 percent of all mortgages it has purchased. By the end of 1982, the FNMA had lessened the size of its deficit, in large measure by altering the mix of its portfolio holdings, and showed a profit of $15.0 million in the first quarter of 1983, the first quarterly profit since the fourth quarter of 1980.

The Federal Home Loan Mortgage Corporation

The Federal Home Loan Mortgage Corporation (FHLMC) is a federally chartered, tax-exempt corporation created to correct imbalances in the supply of conventional mortgage credit within the thrift industry by moving funds from capital surplus to deficit areas and by attracting funds into mortgage lending from sources outside the thrift industry. The FHLMC was established under the control of the Federal Home Loan Bank Board (FHLBB) by Title III of the Emergency Home Finance Act of 1970.

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3. The FNMA began to purchase conventional mortgages in 1972.

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The FHLMC is authorized to purchase and make commitments to purchase residential mortgages approved by the Secretary of HUD for participation in any federal mortgage insurance program, and residential mortgages from any Federal Home Loan Bank or member thereof. Residential mortgages from the Federal Savings and Loan Insurance Corporation (FSLIC), or from any other financial institution, the deposits or accounts of which are insured by an agency of the U.S. government, also may be purchased by the FHLMC. The FHLMC may borrow, give security, pay interest or other return, issue notes, debentures, bonds, or other obligations or other securities including without limitation MBSs to be guaranteed by the GNMA. The FHLMC operates a daily program for the purchase of mortgages with a fee for participation.

APPENDIX B. RECENT HOUSING FINANCE LEGISLATION AND CHRONOLOGY OF REGULATORY ACTION

TABLE B-1. RECENT HOUSING FINANCE LEGISLATION

Legislation and Date Enacted[a]	Provisions
Financial Institutions Regulatory and Interest Rate Control Act of 1978-- November 10, 1978	Enabled the FSLIC to facilitate merger, consolidation, or acquisition of assets of an association following its default. Strengthened FHLBB powers over association officers, directors, and related organizations. Created the interagency Federal Bank Examination Council to encourage uniformity in financial institution supervision.
Housing and Community Development Amendments of 1979-- December 21, 1979	Increased one-family home loan limits for federal associations. Raised FHA loan limits and expanded the FHA graduated payment mortgage (GPM) program. Raised FNMA and FHLMC loan ceilings. Exempted FHA loans from state usury ceilings.
Depository Institutions Deregulation and Monetary Control Act of 1980-- March 31, 1980	Extended savings interest rate control for all depository institutions and the thrift institution differential for six years. Shifted rate-setting authority from individual agencies to a Depository Institutions Deregulation Committee. Increased FSLIC and FDIC insurance for individually owned savings accounts from $40,000 to $100,000. Extended the federal override of state usury ceilings on certain mortgage and other loans. Authorized nationwide NOW accounts effective at year-end 1980 and established levels of reserves that must be held against NOW balances. Authorized investment of up to 20 percent of assets of federal associations in consumer loans, corporate debt securities, and commercial paper. Eased or removed lending restrictions, including geographical limitations, loan-to-value ratios, and treatment of single-family loans exceeding specified dollar amounts.

(Continued)

TABLE B-1. (Continued)

Legislation and Date Enacted[a]	Provisions
Housing and Community Development Act of 1980--October 8, 1980	Permitted negotiated interest rates on certain FHA loans. Mandated HUD action to either disapprove or approve initiation of a mortgage-backed securities (MBS) program by the FNMA.
Omnibus Reconciliation Act of 1980--December 5, 1980	Limited the issuance by states and municipalities of tax-exempt mortgage revenue bonds for housing purposes. Provided for both the limits and tax exemption of such bonds to expire in three years.
Economic Recovery Tax Act of 1981--August 13, 1981	Created the All Savers certificate. Increased annual contribution limits on Individual Retirement Accounts (IRAs).
Veterans' Disability Compensation, Housing, and Memorial Benefits Amendments of 1981--October 17, 1981.	Established a graduated payment plan as part of the VA loan guaranty program.
Garn-St. Germain Depository Institutions Act of 1982--October 15, 1982	Provided capital assistance through net worth certificates to financially weak depository institutions that have suffered earnings and capital losses. Mandated the creation of a deposit instrument equivalent to money market mutual funds. Advanced the deadline to eliminate interest rate differentials from March 31, 1986, to January 1, 1984. Provided expanded authority to make commercial, agricultural, and corporate loans to federal savings and loans and mutual savings banks. Authorized the change between chartering status as a federal savings and loan and a federal savings bank and/or between the stock and mutual form of chartering. Authorized the FNMA to issue preferred stock and made such stock freely transferable.

a. Date enacted is the date on which legislation was signed into law.

TABLE B-2. CHRONOLOGY OF RECENT HOUSING FINANCE REGULATIONS

	The Federal Housing Administration
May 20, 1982	Negotiated rates on a limited number (the greater of 50,000 or 10 percent of the Section 203 mortgages insured in the previous fiscal year) of FHA-insured mortgages were allowed.
May 26, 1982	Ratio of housing expense to borrower income allowed on FHA-insured mortgage loans was raised from 35 to 38 percent of net effective income. Limit on housing expenses and other recurring charges was raised from 50 to 53 percent.
June 4, 1982	Two versions of the growing equity mortgage became eligible for FHA insurance under Section 245 Graduated Payment Mortgage program.
September 8, 1982	Collections of up-front lump-sum premium established by the Omnibus Budget Reconciliation Act of 1982.
Spring 1983	Delegated processing by lenders with five years of conventional single-family loan origination experience was allowed. In-house appraisals can be performed by lenders with property appraisers on their staffs.
	The Veterans Administration
October 17, 1981	Graduated payment mortgage loan plans became eligible for VA guarantee.
May 26, 1982	Growing equity mortgages became eligible for the VA home loan guarantee.
September 8, 1982	Omnibus Budget Reconciliation Act of 1982 levied 1/2 percent fee on guarantees issued on loans closed between October 1, 1982, and September 30, 1985.

(Continued)

October 27, 1982	Restriction against VA guarantee of loans with following characteristics was lifted: o loans on homes in communities with age restrictions; o loans on homes with resale price restrictions; o mortgage loans provided by state and local housing agencies at below-market-interest rates.

The Government National Mortgage Association

April 23, 1979	Securities backed by five-year graduated payment mortgage loans, insured by the FHA, became eligible for the GNMA guarantee.
May 17, 1982	Securities backed by pools of graduated payment mortgage loans, guaranteed by the VA, became eligible for the GNMA guarantee.
October 1, 1982	Fees under the GNMA MBS guarantee program were increased. A new Issuer Application fee of $250 was established, and the Commitment Application fee was increased from a flat $500 to the following: o $500 for the first $1.5 million of commitment amounts, plus o $200 for each $1 million (or part thereof) above $1.5 million.
January 1983	GNMA-guaranteed MBSs were first sold by investment brokers (Merrill Lynch, Dean Witter, Prudential-Bache, and Shearson/American Express) to general public investors in any amount over $1,000.
February 1, 1983	Securities backed by pools including growing equity mortgages and ten-year graduated payment mortgages (i.e., payments will increase 2-3 percent each year for ten years) became eligible for the GNMA guarantee.

(Continued)

TABLE B-2. (Continued)

July 1, 1983	GNMA II--a new MBS program with jumbo pools, a central paying agent, and electronic funds transfer among its features--was introduced.

The Federal National Mortgage Association

December 1981	Securities or trust certificates representing fractional interests in pools of conventional home mortgages originated by primary market lenders (e.g., savings and loan associations, mortgage bankers) were first issued.
March 1982	Program initiated in which state pension plans receive FNMA securities backed by mortgage loans made through savings and loan associations using state pension funds.
June 1982	Purchase of second mortgage participations and loans, both fully amortized and balloon payment, authorized.
July 1982	First purchases of cooperative housing share loans made.
	Purchase and commitment-to-purchase program initiated for growing equity mortgages with fixed schedules and for rapid payoff loans.
September 1, 1982	Securities backed by growing equity mortgages and rapid payoff loans first issued with the FNMA guarantee.
	FHA/VA loans of any age and interest rates first exchanged for the FNMA MBS or trust certificate.
October 15, 1982	Requirement lifted that all conventional fixed-rate mortgages bought by the FNMA be called payable in full on their seventh anniversary.

(Continued)

TABLE B-2. (Continued)

October 1982	Commitments made to purchase loans to help builders sell their inventory through the Home Mortgage Access Corporation (HOMAC), a subsidiary of the National Association of Home Builders (NAHB).
November 22, 1982	Resale-refinancing program for new mortgage loans on homes for which the FNMA holds the existing mortgages expanded to refinance conventional, FHA, and VA existing mortgages with conventional mortgage loans.
December 22, 1982	Maximum debt-to-capital ratio raised by HUD from 25-to-1 to 30-to-1.
March 1983	Biweekly Free Market System auction for mortgages terminated.
March 15, 1983	Major home sellers--large builders and realty chains and others associated with home finance, such as mortgage insurers, groups of small lenders, and regional and national trade groups--authorized to buy commitments directly from FNMA.

The Federal Home Loan Mortgage Corporation

August 1981	Swap program instituted.
July 1982	Growing equity mortgages first bought for pools to back participation certificates.
October 15, 1982	Acceptable loan values on refinancing mortgages increased from 80 percent to 90 percent of the appraisal value.
November 1, 1982	One-half percent fee per dollar value of mortgage purchased from home lenders not members of the federal savings and loan insurance system canceled.

(Continued)

TABLE B-2. (Continued)

January 1983	Agreement made for standby commitments to purchase loans made to help builders sell their inventory through the Home Mortgage Access Corporation (HOMAC), a subsidiary of the National Association of Home Builders (NAHB).
March 1, 1983	Adjustable rate mortgage program which limits annual rate changes to 2 percent was eliminated.
March 15, 1983	Weekly auction replaced by a daily administered-price offering system.
April 1983	Fifteen-year fixed-rate mortgage program now offered through NAHB's HOMAC program opened to all seller-servicers.
	Two new adjustable rate mortgage programs--with rates tied to three-year and five-year Treasury securities--made available.
	FHA/VA loans accepted in the SWAP program.
June 1983	Collateralized mortgage obligations (CMOs), or mortgage-backed bonds collateralized by long-term, fixed-rate mortgages, were first offered. The CMOs were issued in three classes with fast-, intermediate-, and slow-pay characteristics and with all the classes receiving semiannual payments of both interest and principal.

APPENDIX C. ALTERNATIVE MORTGAGE INSTRUMENTS

TABLE C-1. SUMMARY OF ALTERNATIVE MORTGAGE INSTRUMENTS

	Distinguishing Feature	Status: Federally Chartered Thrifts	Status: National Banks	Prevalence
Variable Rate Mortgage (VRM)	Mortgage rate is linked to a reference rate and may change during life of loan.	Authorized nationwide in 1979; restrictions relaxed in 1981.	Authorized nationwide in 1981.	Variants popular in California, Ohio, and Wisconsin.
Graduated Payment Mortgage (GPM)	Payments increase gradually in early years of loan and then level off.	Authorized nationwide in 1979.	Subject to state laws.	California, Florida, Texas, Colorado, and Arizona account for more than one-half of all FHA-insured GPMs.
Shared Appreciation Mortgage (SAM)	Lender shares in appreciation of the property.	Regulations proposed in 1980; not yet authorized.	Subject to state laws.	Incipient; long used in non-residential mortgages.
Growing Equity Mortgage (GEM)	Increases in monthly payments, which are tied to the market, are used to reduce principal and speed up loan amortization.	Authorized under laws existing for GPMs.	Subject to state laws.	
Price Level Adjusted Mortgage (PLAM)	Payments are constant in real terms.	Discussion stage.	Discussion stage.	

a. Standard, fixed payment mortgage.